HRMagazine™

The Business of People

JULY 2004 VOL. 49, NO. 7

Overseeing Pension Management

Scandals and litigation are driving retirement plan committees to scrutinize the details.

By Carolyn Hirschman

Retirement plan committees are going formal. Their increasing attention to structure and process may not call for tuxedos and corsages, but it just might keep government auditors and potential plaintiffs at bay.

It's more important than ever for executives who manage employees' retirement money to dot their i's and cross their t's, experts say. Any breach of fiduciary duties could lead to lawsuits by participants and put committee members' personal assets at risk.

Plan sponsors can blame—or perhaps thank—the Enron case for a renewed focus on committees doing their jobs right. Also driving the trend are the ongoing mutual fund scandals and the federal Sarbanes-Oxley Act of 2002, which imposed new requirements on retirement plans. (See "Holding Committees Accountable")

These events "brought everyone back to basics," says Cynthia A. Van Bogaert, a benefits lawyer at Boardman Law Firm in Madison, Wis. "I've had all my clients looking closely at their procedures."

Senior HR executives, who often sit on retirement plan committees, play a vital role in pension management by overseeing and delegating the day-to-day administration of plans, keeping top corporate officers in touch with employees' retirement habits and needs, and consulting on investments.

"I'm the person people think of when they think of our retirement plan," says Steve Klapper, a benefits manager who sits on the three-person committee that runs the 401(k) plan of American TV & Appliance Inc., a 2,000-employee retailer in Madison, Wis. ›

DALEGLASGOW.COM

Fiduciary Focus

Recent attention to committee composition and procedures reflects a general concern with the fiduciary requirements of the federal Employee Retirement Income Security Act (ERISA), the 1974 law that governs about 7 million private benefits plans. ERISA requires fiduciaries—those with discretion or authority over a plan and/or its assets—to run their plans prudently and in the best interests of participants and beneficiaries.

ERISA does not require that retirement plans be run by committees, and many smaller plans operate without them, with one or two top executives making decisions. However, many benefits experts recommend designating a formal committee to handle the workload, to air a variety of viewpoints and to satisfy ERISA's requirements for prudent processes. (See "Committee Management")

"In the retirement arena, you have to be concerned with prudent investment practices. The best way to do that is through a committee," says Trisha Brambley, president of Resources for Retirement Inc., a Newtown, Pa., consulting firm.

Plan sponsors with 1,000 or more employees generally have committees, usually a single body that handles all plan responsibilities. The largest employers have two committees, one for administration and another for investments. Unlike a single committee, in which members are equally liable for all decisions, a two-committee structure allows each committee to focus on its decisions and actions, and reduces its responsibility and liability.

"As long as each committee member operates in a specific scope of delegation, they're liable only for that delegation," says Matthew D. Hutcheson, a retirement consultant in Portland, Ore. The plan document must specify in writing which duties have been delegated to which committee.

Craig Pett, a benefits lawyer at Atlanta-based law firm Alston & Bird, says he's seen a "growing minority" of plans forming two committees because "people are concerned about their own personal liability." A vice president of HR on an administrative committee would not be liable for the decisions and actions of the investment committee, he notes.

Holding Committees Accountable

Many committees, especially those in charge of small and mid-size plans, were not well run in the past because they were not business priorities, attorneys say.

"They didn't know who their members were. They didn't have regular meetings. The process kept breaking down for many employers," says David L. Wolfe, a partner in Gardner Carton & Douglas, a Chicago law firm.

Along came Enron, the once-powerful Houston-based energy company whose accounting tricks led to bankruptcy, securities prosecutions, and a class-action lawsuit against former executives and benefits committee members alleging breaches of fiduciary duties.

"That was a watershed change in how companies operated, including how they operated their retirement plan committees," Wolfe says. The result is that committees are now scrutinizing everything from membership to record keeping.

Setting Up a Committee

ERISA requires plan sponsors to name a plan administrator and at least one "named fiduciary," often the chief executive or the board of directors. If no one is named, the plan sponsor becomes the fiduciary by default. These fiduciaries, in turn, can form a committee to manage the plan, appointing senior executives and managers from the HR, finance, accounting and legal departments and, often, operating divisions. In addition to their area of expertise, members should have enough time and passion for the job.

A written plan document describes these positions and their basic responsibilities.

The committee's job is to set big-picture strategy and make high-level decisions, leaving the details to staff and outside service providers.

Committee members' duties fall into two areas: administration and investment management. (See "Chief Duties of Retirement Plan Committees")

"The majority of the work of a typical plan is on the investment side. The exception is for legal compliance and changes in the way the plan runs," says David L. Wolfe, a partner in Gardner Carton & Douglas, a Chicago law firm.

"The first order of business is making sure everyone understands their roles," says Matthew Gnabasik, managing director of Blue Prairie Group, a Chicago HR consulting firm. "You can't assign away fiduciary responsibility. You can hire other people to help you, but you can never get rid of it."

HR executives need not be Wall Street stock pickers to oversee investments. What's needed are "good, traditional managerial skills," according to Donald B. Trone, who directs the University of Pittsburgh's Center for Fiduciary Studies.

"They have to be able to monitor things, ask really good questions and manage the process," adds Hutcheson.

Maureen Arnoldy, HR director of Strick Trailer Corp., says she's learned about investment management through eight years on a retirement plan committee, close work with her company's chief financial officer and training provided by an outside consultant. About 600 employees participate in the 401(k) offered by Strick Trailer, a transportation-equipment manufacturer based in Monroe, Ind.

Many benefits experts recommend designating a formal committee.

On the administrative side, HR's input is critical because it links the C-suite and employees. "The HR people know the plan participants. You have to understand the composition of the workforce in selecting investment options," says David L. Wray, president of the Chicago-based Profit Sharing/401(k) Council of America.

"[I have] daily contact with participants," says American TV's Klapper. "Not a day goes by that I don't get a call about the retirement plan."

Arnoldy says that her HR background helps Strick Trailer's committee find the best ways to communicate with participants. "My role on the committee is to improve communications, to find the proper education vehicles so people can make wise investments," she says.

For voting purposes, a committee should consist of an odd number of individuals—often three to nine people—benefits experts say. "Three becomes so small you might have quorum problems. Nine becomes unwieldy from a scheduling perspective," notes Wolfe.

In general, committee members do not serve set terms; they leave only if they resign from the committee or leave the employer. The benefits of longevity—continuity, experience and expertise—usually outweigh the possible negative influence of an insiders' network, Van Bogaert says.

To ensure continuity, committee members should be listed by their job titles, not their names. That way, for example, the vice president of HR is always on the committee, no matter who holds the job. An investment policy statement and other written records can also guide new members.

Some committees appoint independent fiduciaries to sit on the panel as advisers. Government regulators choose such third-party retirement experts to replace leaders of bankrupt and abandoned retirement plans, while some companies simply want to add value to their retirement committee, Hutcheson says.

For example, Strick Trailer plans to add Brambley of Resources for Retirement to its three-person committee because her "wealth of knowledge" will help members better understand the retirement industry and administer the 401(k), Arnoldy says.

With the exception of union-run plans, most retirement committees do not include an employee representative. Some experts say rank-and-file workers don't have the necessary expertise, but others believe it's a good idea to get employee feedback and ideas—if not through the committee, then through a separate advisory group. Trone recommends tapping employees with managerial skills who are "best in step with the pulse of participants."

Top Executives' Role

A trickier decision is whether to exclude the chief executive and chief financial officers from the plan committee. At many small and private companies, CEOs are intimately involved in the details of plan management.

Committee Management

Retirement plan committees should meet at least annually to review investment performance and other matters. Many experts recommend that committees meet two to four times per year, with special meetings as needed, such as to consider what to do when a mutual fund in the lineup is under investigation. The committee also works between formal meetings, reviewing reports and conferencing by telephone.

It's a good idea to designate a chairman to convene meetings and set agendas, and a secretary to take and maintain minutes and other records. It's possible but not necessary to form subcommittees to conduct vendor searches and other ad hoc or ongoing tasks. Taken together, these practices show that the committee follows certain procedures and documents its decisions—elements regulators and courts look for to demonstrate prudence.

Training can bolster the experience of both new and old committee members. It can range from a one-hour session with the plan sponsor's lawyer or consultant to days of formal classes. Whatever its scope, training should drive home the importance of fiduciary responsibility and the legal dangers of not living up to one's duties.

"I'm expecting to see training become more common" in light of the Enron scandal and other litigation over violations of the Employee Retirement Income Security Act, says Serena Simons, an attorney at Miller & Chevalier in Washington, D.C.

'Sometimes you want to protect your most senior officials from themselves.'

Chief Duties of Retirement Plan Committees

ADMINISTRATION

- Design plan.
- Choose and monitor third-party record keepers, other service providers.
- Ensure government compliance.
- Amend plan document as needed.
- Handle employee communications.
- Decide benefits claims and appeals.
- Provide for financial education.

INVESTMENT MANAGEMENT

- Write and ensure adherence to investment policy statement.
- Choose specific investments or recommend them to full committee.
- Hire and monitor investment managers, other service providers.
- Review investment performance and make changes as needed.

But large publicly traded companies, especially those with company stock among their plan's investment options, are rethinking committee composition, lawyers say. Participants suing Enron Corp.'s executives and committee members allege in part that they should have disclosed negative financial information about the company to warn participants against buying an imprudent investment—increasingly worthless stock in the Houston-based energy company.

The problem is that CEOs and CFOs wear two hats: one as a company insider with access to "material" information that could affect the company's stock price and another as a plan committee member. As the Enron case shows, the two roles aren't always compatible.

Under federal securities laws, a CEO must disclose bad news that can affect a company's stock price for shareholders, who may include participants. It's not in the CEO's business interest to discourage the purchase of company stock. But as a committee member acting in the best interests of participants, he may have to suspend participants' investments in that stock.

A U.S. District Court's September ruling in the Enron case suggests that plan fiduciaries may not be able to rely on a conflict with securities laws to excuse inaction as fiduciaries, according to a Watson Wyatt analysis.

Wolfe's advice: If plan investment options include company stock, don't put an executive with access to material nonpublic information on the committee. There's too much potential for conflict of interest that can end badly. "Sometimes you want to protect your most senior officials from themselves."

Until the Enron case is settled, many plans will try to tread a middle ground, by placing CEOs or CFOs on committees but making sure they wear the right hat at the right time.

Regardless of who's on the committee, plan sponsors should document committee appointments and members' acceptance and understanding of their duties, lawyers say. As with other aspects of running a plan, a written record shows that a prudent process was followed in making decisions. For example, documenting how and why you picked one service provider over others can help protect a plan sponsor if the vendor later performs poorly. (See "Fiduciary Fitness" in the September 2003 issue of *HR Magazine*.)

The employer should purchase fiduciary liability insurance, which pays for legal costs except for those brought on by fraud, gross negligence and other illegal acts. Committee members may also have plan sponsors indemnify them—that is, agree to pay their legal costs if claims against them arise.

These nuts and bolts of setting up and running a committee may not be glamorous, but the devil is in the details. Following the three P's—prudence, process and procedure—can result in a well-functioning committee that provides the best retirement plan for participants while insulating top executives from legal liability. HR

Carolyn Hirschman is a business writer based in Rockville, Md. She has written for a variety of business publications and has covered workplace issues since 1991.

Reprinted from HR Magazine, © 2004, Society for Human Resource Management, www.shrm.org.
Reprinted by FosteReprints (866) 879-9144.
To purchase reprints online visit: www.shrm.org/hrmagazine/reprintsandpermissions

1283-2004-1448 D.O.F.U. 01/03/05